ADVANCED CORPORATE REPORTING

PROFESSIONAL 2 EXAMINATION - APRIL 2019

NOTES:
You are required to answer **ALL** Questions.

Provided are pro-forma:

Statements of Profit or Loss and Other Comprehensive Income By Expense, Statements of Profit or Loss and Other Comprehensive Income By Function, and Statements of Financial Position.

Time Allowed
3.5 hours plus **20 minutes** to read the paper.

Examination Format
This is an open book examination. Hard copy material may be consulted during this examination, subject to the limitations advised on the Institute's website.

Reading Time
During the reading time you may write notes on the examination paper but you may not commence writing in your answer booklet.

Marks
Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

Answers
Start your answer to each question on a new page.

You are reminded to pay particular attention to your communication skills, and care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples, where appropriate.

Answer Booklets
List on the cover of each answer booklet, in the space provided, the number of each question attempted. Additional instructions are shown on the front cover of each answer booklet.

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

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Time Allowed: 3.5 hours, plus **20 minutes** to read the paper. You are required to answer **ALL** questions.

If you make an assumption in any question, please state your assumption clearly.

Case Study

General Security Services (GSS Plc) is an international security company with its head office located in Ireland. GSS was founded in 2001 by Conor Gorman and Andrew Potter, both former security analysts who had served in the armed forces for many years. GSS offers a complete range of security services to corporate clients. The company has operations in Ireland and throughout Europe. The original focus of the business was to install security equipment but it has since expanded into design, maintenance, monitoring and security consultancy services.

GSS made a number of successful acquisitions in the past decade. The company was launched on the Irish Stock Exchange in 2008. It currently has a listing on both Euronext Dublin and the London stock exchange. The group is headquartered in Galway and employs staff across the world. It is made up of GSS and its subsidiaries IKAN and BARN. GSS purchased 80% of the share capital of IKAN on 1st January 2006 for €2m when IKAN's retained earnings were €500,000. 100% of BARN was acquired two years later on 1 January 2008 for €1.5m. BARN's retained earnings at that date were €340,000. At the date of acquisition, the fair values of both entities were equal to their carrying values.

You are the financial controller of GSS. It is now January 2019 and you are busy preparing the financial statements for the year ended 31 December 2018. You are under a lot of pressure as you have been asked to present financial statements to the Board of Directors in two days' time. The first draft of the financial statements of each of the three GSS companies have been prepared and are now on your desk. You have also managed to compile a list of outstanding issues that you need to consider before the financial statements are presented to the Board.

It is 10 a.m. Armed with an americano and a protein bar, you are about to set to work on these issues, when your email inbox pings. There is a message from Conor Gorman, CEO. The email reads:

To: Financial Controller (controller@GSS.ie)
From: Conor Gorman (conorgorman@GSS.ie)
Subject: Meeting Friday morning 10am

Hi
I know that you are extremely busy compiling the financial statements today so I will keep this email short. I look forward to our meeting on Friday. I will be travelling back from the USA Thursday night so I should be in the office by 9am Friday morning.

I am emailing you now as Andrew and I would like to have a quick chat with you ahead of the board meeting. An interesting proposal has come our way and we would like to tease out some of the reporting issues with you. We value your opinion and respect your expertise in all financial reporting matters. As you are aware our shareholder base can be somewhat sensitive to change, especially change that does not have an immediate positive effect on our results. I have attached a brief outline of the proposal and our thoughts. Could we meet at 10am Friday to discuss? Following our chat we may or may not add this matter to the AOB at the board meeting.

Regards
Conor

You download the attachment and add it to the list of outstanding matters. The details are outlined in outstanding issue (9) which follows.

OUTSTANDING ISSUES IN RESPECT OF THE GSS GROUP 2018 FINANCIAL STATEMENTS

Note: You may assume that the transactions below are net of taxation except for outstanding issue 7 relating to deferred taxation.

1. GSS earns revenue from a number of different sources. As part of your preparation work for the 2018 accounts you attended a course on IFRS 15 - *Revenue from Contracts with Customers*. Following this, an internal review was carried out on the company's accounting policies. One area requires revision. You have summarised the details below:

Installation and Monitoring Services

GSS provides a range of security services to corporate clients. Upon signing a contract with a customer, GSS designs and installs security equipment at clients' premises. There is no charge for this service. Once the equipment is installed a monitoring arrangement is then put into action. The typical contract will be for five years. It is the current policy of the company to recognise total contract revenue on a straight-line basis over the period of the contract. Customers are charged on this basis. Customers paid on the due dates in 2018.

As well as security packages, GSS also sell stand-alone security equipment to clients and monitoring services to clients who have already security equipment installed in their premises.

You establish the following in relation to the sale and monitoring packages that were sold during 2018.

Number of Contracts sold	On 1 January 2018	150
	On 1 July 2018	150
	Cumulative sales	300 contracts
Revenue per Contract	€140,000 (excluding VAT)	
Sale of Equipment stand-alone	€60,000	
Monitoring contract only	€18,000 per annum	

(You should assume that the cost of sales has been correctly stated in the financial statements)

From your review you have also established that the prior period effect on revenue re-statement is a decrease of €50,000. GSS has elected to apply the cumulative effect approach on transition, as permitted by IFRS15.

2. GSS has three investment properties on its books. Investment properties are measured in the financial statements at fair values (as permitted under IAS40 – *Investment Properties*) while owner-occupied properties are measured at cost less accumulated depreciation and impairment losses. The properties are currently presented at 2017 year-end valuations. No adjustments have been made for the current year.

During 2018, two of GSS investment properties changed their use. Property ELO, a commercial warehouse that had been let on a commercial basis for a number of years, was re-assigned as office space for the company. The tenants were notified and vacated the premises on 1 May 2018. ELO was valued at €400,000 on 1 January 2018, €380,000 on 1 May 2018 and €370,000 on 31 December 2018. Company policy is to depreciate owner-occupied property at a rate of 2% per annum on a monthly basis.

The second property MOW was acquired in 2012 for €500,000 and is valued at €450,000 on 1 January 2018. In late 2018, resulting from falling property prices in this area, the directors agreed to dispose of this property. The property, empty since September, was put on the market in October with an asking price of €440,000. Although there has been some interest in the property, no firm offers had been made by the year end. Estimates of disposal costs are about €30,000. The value remained at €440,000 at 31 December 2018.

The remaining investment property AGO is valued at €925,000 at 31 December 2018.

3. In January 2018, IKAN was awarded an Enterprise Grant of €800,000. This was the first time IKAN had been in receipt of any grant income. In drawing up draft accounts for the year ended 31 December 2018, €800,000 was debited to the company's bank account and credited to current financial liabilities.

The grant has been awarded on the following basis:

ITEM	GRANT CONTRIBUTION	Conditions
Acquisition of Machinery	€270,000	
Plant Fit-out	€200,000	
Acquisition of Cutting Tools	€150,000	
Wages	€180,000	Over 3 years
Total	€800,000	

The three year wages budget for the company is as follows:

Year	2018	2019	2020
Wages	€70,000	€90,000	€110,000

The depreciation policy of the company provides that depreciation should be charged at a rate of 10% per annum straight-line on all plant, machinery and cutting tools.

It is the policy of the GSS group to present government grants using the deferred approach as permitted by IAS20 *- Accounting for Government Grants and Disclosure of Government Assistance.*

4. GSS has elected for early implementation of IFRS16 - *Leases* in 2018, one year ahead of the required date. The company has one lease in force that is classified as an operating lease. The directors, aware of the possible backlash of rising gearing levels, issued a circular to shareholders early in the year informing them of the change. However, no revisions have been made to the accounts to date and the 2018 rental has been charged to operating expenses. You have chosen the cumulative effect approach on transition, as permitted by IFRS16. You have established the following:

Right of Use asset at 1 January 2018	€44,161
Lease Liability at 1 January 2018	€49,173
Cumulative effect on previous earnings	€5,012
Remaining period of lease	4 years
Effective interest rate on remaining liability	10%
Rental paid annually in arrears on 31 December	€15,512

5. BARN measures inventories on a FIFO basis. A review of BARN's inventories indicate that certain items currently measured at cost of €160,000 now have a selling price of €80,000 while other items measured at €90,000 cost could now be sold for €170,000. Disposal costs in each case are estimated to be €5,000.

IKAN trades with GSS. During the year ended 31 December 2018, IKAN sold €1m (selling price) of goods to GSS at a mark-up on cost of 25%. Half of these goods had been processed and resold by GSS by the year-end. Although there is an agreement that intra-group payables be paid at the year end, it does not always occur. In practice, GSS pays for the goods on an intermittent basis. At 31 December 2018, there is an inter-group receivable balance in IKAN's trade receivables of €150,000. The corresponding inter-group payable €200,000 is included in GSS trade payables. With regard to the above difference in these closing balances, you have recently discovered that you mistakenly debited a payment to IKAN to your Trade Receivables account.

6. One of GSS divisions, located in Southern Europe, lost a lucrative contract in 2018. As a result, a cost savings plan was drawn up. The plan involves the loss of 25 jobs and was finalised in October 2018. It was published on the company website in early November.

In early December, employees were called to a meeting to inform them of the situation. They were told that the plan would be implemented over a 12-month period commencing in February 2019. Employees could either leave the company on 1 February 2019 with a termination payment of €40,000 per member or remain with the company for another 12 months to facilitate the orderly winddown of the business. If they choose the latter they will receive redundancy lump sum payments on 31 January 2020 of €60,000 per employee. The terms and conditions of remaining staff in this division will also be affected by the downturn. It is expected that salaries will be cut by 20%

resulting in operating savings of €250,000 per annum. The administrative and legal costs associated with the restructuring are estimated to be €65,000. No entries have been made to the financial statements to record this transaction. *(You can ignore the time value of money for this issue.)*

7. The deferred taxation liability in the draft financial statements of GSS above represents the deferred tax balance at 1 January 2018 and is made up entirely of an excess of capital allowances over book depreciation taxed at a rate of 12.5%.

Further differences between the carrying amounts and the tax base have now been identified as follows:

Difference	**€'000**
Permanent Difference	10
Taxable temporary timing differences	400

The corporation tax rate remained unchanged in 2018.

8. Goodwill incurred on the acquisition of both subsidiaries was calculated using the proportionate method. Following an impairment review on 5 January 2019, it was deemed that IKAN is not impaired and its recoverable value remains higher than its carrying value. However, there are signs of impairment in BARN, which sells security equipment to Russian Government Services. This revenue stream has been declining steadily over the past two years, with BARN losing out to US competitors for this business. As a result, the carrying value of the subsidiary exceeds its recoverable value by €60,000.

9. Ocean O, a private equity group has approached Conor Gorman and Andrew Potter with an expression of interest in acquiring a 10% share of equity in GSS for an agreed valuation. Ocean O is a global investor in security and cybersecurity and this investment would bring a level of expertise to the Board of Directors as well as an injection of capital. Ocean O has proposed a meeting to explore the idea and the directors have agreed to attend this meeting.

One of the major agenda items for this meeting will be the selling price of a 10% stake in GSS. Although GSS is trading on both Euronext Dublin and the London stock exchange respectively, a stake of 10% would attract a significant premium over the quoted share price. A valuation based on multiples of revenue is more commonly used in the securities industry and this method would appeal to the directors. However, Conor and Andrew are aware that any discussion on revenue is likely to include some discourse on the effects of IFRS 15 - *Revenue from Contracts with Customers*. The directors have heard about IFRS15 but they know very little about it. They have not been paying attention to any of the memos that you have sent to them during the year. They know that there are changes coming and that you have adjusted the financial statements but they are unsure of the rules of revenue recognition. During informal discussions with the accounting team, it has been mentioned that there is a five-step approach on revenue recognition. Conor Gorman has stated that he would like to know more on this.

The second and somewhat related matter concerns the gearing levels in the GSS group. Andrew Potter is worried that a high gearing level may have a negative impact on the Ocean O investment. The directors need to be clear about where they stand before they enter into any negotiations. They are particularly anxious about the outcome of recent legal action taken by the group that, so far, has been kept out of the public realm. The action was taken against a former employee who, GSS claims, diverted a number of large contracts away from the group for his own personal benefit. The defendant is counter suing for personal damages. Conor and Andrew have now been advised that GSS is unlikely to succeed in its action. Furthermore, should the case go against GSS, the group will be held responsible for all of the legal costs of €1m and damages of up to €5m. However, there is a 20% chance that the judge may direct the defendant to pay his own share of the legal costs which are estimated to be about €350,000. The directors are very concerned about this and do not want the case mentioned in the financial statements until a final verdict has been reached. They feel that any disclosure of the case would cause serious reputational damage to the group. They consider this case to be of a highly sensitive and confidential nature and they do not want any mention of it in the financial statements either this year or next year. The directors require your advice on this matter.

REQUIREMENT:

(a) Prepare a short report that (i) gives reasons why a new accounting standard on revenue recognition was introduced and (ii) discusses how to apply the five step approach on revenue recognition as per IFRS 15 - *Revenue from Contracts with Customers.*

(10 marks)

(b) Prepare a memorandum which:

(i) Provides an explanation and an analysis of the required IFRS accounting treatment for outstanding issues 1 to 8. You should prepare relevant calculations and discuss the impact, where appropriate, on the Consolidated Statement of Profit or Loss and Other Comprehensive Income and the Consolidated Statement of Financial Position for the GSS Group for the year ended 31 December 2018.

(50 marks)

(ii) Includes the Consolidated Statement of Profit and Loss and Other Comprehensive Income (Extracts) and the Consolidated Statement of Financial Position for the GSS Group for the year ended 31 December 2018 in accordance with relevant IFRS (showing all relevant workings).

(30 marks)

PLEASE NOTE: You are NOT required to incorporate any of the financial reporting implications of outstanding issue 9 into your answers for b (i) and (ii).

(c) Appraise the financial reporting implications of the legal action taken by GSS against the former employee. You should also comment on how such financial reporting implications may impact upon the group's level of gearing, and, consequently the potential investment in GSS by Ocean O.

(10 marks)

You are NOT required to adjust the consolidated financial statements for the GSS Group for any answer that you prepared in part (c).

[Total: 100 MARKS]

Appendix 1: The Draft Financial Statements for GSS, IKAN and BARN.

Draft Financial Statements
Draft Statements of Financial Position as at 31 December 2018:

	GSS €'000	IKAN €'000	BARN €'000
ASSETS			
Non-Current Assets			
Property, plant and equipment (NBV)	6,000	2,790	750
Investments			
Shares in IKAN	2,000		
Shares in BARN	1,500		
Investment Properties	1,600		
	11,100	2,790	750
Current Assets			
Inventories	3,490	700	350
Trade Receivables	2,080	450	240
Cash and cash equivalents	3,000	50	210
	8,570	1,200	800
TOTAL ASSETS	19,670	3,990	1,550
EQUITY and LIABILITIES			
Equity			
Ordinary shares €1 shares	6,000	300	500
Share Premium	2,300		
Retained Earnings	7,000	900	700
Other Reserves	1,200		
	16,500	1,200	1,200
Non-Current Liabilities			
Financial Liabilities	200	1,230	
Deferred Taxation	250		
Retirement Benefit Obligations	600		
	1,050	1,230	0
Current Liabilities			
Payables	1,050	500	300
Financial Liabilities	470	800	
Current Taxation	600	260	50
	2,120	1,560	350
TOTAL EQUITY AND LIABILITIES	19,670	3,990	1,550

Draft Statements of Profit and Loss and Other Comprehensive Income (Extracts)
for the year ended 31 December 2018:

	GSS €'000	IKAN €'000	BARN €'000
Profit before tax	4,000	300	250
Taxation	330	33	20
Profit for the year	3,670	267	230

END OF PAPER

SUGGESTED SOLUTIONS

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(a) Reasons for the introduction of IFRS15 Contracts for Revenue from Customers (10 Marks)

Reasons for change (4) marks. 0.5 headings
5 Step approach (6) marks. One mark for example to 'apply'

IFRS15 was issued in 2015 and is applicable to reporting entities from 1st January 2018. IFRS15 was a joint project between IASB and FASB (USA). The standard was developed in order to improve and enhance the reporting of revenue transactions in financial statements. Former IFRS guidance on revenue recognition concentrated on the transfer of risks and rewards in the recognition of revenue while the new standard focuses on control. Revenue will now be recognised by a vendor when or as control over the goods or services is transferred to the customer. This forms one of a number of criteria that are assessed in determining whether control has been transferred.

Reasons for replacement of IAS18/11:
Risk/return versus control. This is in line with Conceptual framework
IAS18 Lack of clarity on multi-element sales.
Difficulty in distinguishing between sales of goods/services
IAS18 lack of problems in assessing warranties
IAS18 couldn't deal with complex transactions – BUNDLED TRANSACTIONS
IAS18 Disclosures poor. The other significant difference between IFRS 15 and the former standard is that IFRS15 contains significantly more prescriptive and precise requirements in comparison with existing IFRS. This means that for many entities, the timing and profile of revenue recognition will change. In some areas the changes will be very significant and will require careful planning, including for commercial effects.

The full criteria for the transfer of control, is now commonly known as The Five Step Approach:

Figure 1 Revenue Recognition: 5-step Analysis of Transactions

Include a brief explanatory note to each step.

Step (1) Identify the contract
The contract should be clearly defined for both parties, the rights and payment terms should be included, the contract should have commercial substance and it should be probable that the consideration will be exchanged

Step (2) Identify Performance Obligations of the Contract
At the inception of the contract, the entity should assess the goods or services that have been promised to the customer, and **identify as a performance obligation**:

- a good or service (or bundle of goods or services) that is **distinct**; or
- a series of distinct goods or services that are **substantially the same** and that have the same pattern of transfer to the customer.

Step (3) Identify the Transaction Price
The transaction price is the **amount of consideration to which an entity expects to be entitled in exchange** for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (e.g., VAT). In determining the transaction price, consider the variable consideration and constraining estimates, financing component in the contract, non-cash consideration.

Step (4) Allocate the transaction Price to the Performance Obligations
Done in proportion to their stand-alone selling prices. on a relative stand-alone selling price basis). The stand-alone selling price for each performance obligation is the price at which an entity would sell a good or service on a stand-alone basis at contract inception

Step (5) Recognise Revenue as Performance Obligations are satisfied.
At a point in time or over time depending on the obligations.

In many instances the form and timing of revenue recognition will not change from IAS18 but there are particular areas that require careful thought. These include:

1. Is Revenue recognised over time or a single point in time?
2. Does a contract contain one single performance obligation or is it a bundled contract consisting of multiple obligations
3. How should contracts with variable amounts be recognised
4. How should progress be recognised where contracts span a number of accounting periods.

(b) (i) Memorandum

To: Conor Gorman, CEO, GSS Plc.
From: Noleen Cashe. Financial Controller, GSS Plc
Date: 30 April 2019
Re: Annual Financial Statements for the Year to 31 December 2018 and Matters Arising

Please find enclosed the following papers:

(i) An analysis and explanation of the accounting treatment required under IFRS for the issues outstanding, as of yesterday, with regards to the preparation of the Group financial statements for the year ended 31 December 2018. The impact of the treatment of each issue is clearly shown.

(ii) Consolidated financial statements for the year in question (2018).

I will be pleased to discuss any matters relating to these.

____
Noleen Cashe, CPA

Requirement (b)(i) | **Marks**

Summary of Marks. Details below

Issue	Marks
1	7
2	10
3	8
4	6
5	6
6	5
7	5
8	3
Total	**50**

1. Revenue GSS

Monitoring Service

Step 1 - Identify contract.

Contract is for sale of bundled contract of equipment and monitoring services.

Step 2 Identify Performance Obligations

This contract is a bundled contract. There are multiple performance obligations in the contract.
(i) Sale of Equipment (ii) Monitoring Services

Step 3 Transaction Price

The transaction price for a bundled contract is €140,000

Step 4 Allocate the transaction price to the Performance Obligations

The bundle price is split in accordance with the stand alone selling price of each PO
This the price that the entity would sell the good or service or a stand alone basis.

	(€'000)	
Equipment	60	
Monitoring	90	(5 years)
	150	
Bundled transactions	140	
Discount	10	

Discount allocated between equipment and the servicing :

Allocation	Discount	Net (€'000)
Equipment 60,000/150,000*10k	4	56
Monitoring 90,000/150,000*10k	6	84
		140

Step 5 Recognise revenue as PO is completed

		(€'000)
Equipment (€56,000*300)		16,800
Servicing:		
Sold on 1st January 2018	(150*84k/60*12mths)	2,520
Sold 1st July 2018	(150*84k/60*6mths)	1,260
		20,580

AT the moment revenue is recognised on a straight line basis over the period of the contract.

Sold 1st January 150*€140k/5years	4,200
Sold 1st July 150*€140/5years *6 months	2,100
	6,300

Journal required forRevenue that should be recognised this period €20,580k LESS what has already been recognised €6300k
Correction of error to bring revenue in line with IFRS5

	(€'000)	(€'000)	Marks
Debit Receivables	**14,280**		
Credit Revenue		**14,280**	**5**

Prior Year adjustment

retain prior period figures as reported under the previous standards, recognising the cumulative effect of applying IFRS 15
as an adjustment to the opening balance of equity as at the date of initial application (beginning of current reporting period).

	(€'000)	(€'000)	Marks
Debit opening reserves	**50**		**2**
Credit Receivable (or other)		**50**	

Issue (1) **7**

2. Investment Properties GSS

There are three investment Properties to consider:

	Name	Value 1.1.18 (€'000)	Event
	ELO	400	Change of Use to owner Occupied
	MOW	450	Change of use to held for sale Remain in IAS40. Adjust to fair value at year end.
(balancing)	AGO	750	No change Adjust to Fair value at year end.
		1,600	

ELO

IAS 40 for a transfer from investment property carried at fair value to owner-occupied property, the fair value at the change of use is the 'cost' of the property under its new classification [IAS 40.60]

The 'cost' is then deppreciated in accordance with company rules.

	(€'000)
Fair value ELO at 1.1.18	400
Fair value ELO at 1.5.18	380
Change	20
Depreciation at 2% for 8 months (380*2%* 8/12)	5

	(€'000)	(€'000)	
Debit PPE	**380**		
Debit fair value adjust	**20**		**3**
Cr IP		**400**	
Debit Operating Expenses	**5.07**		
Credit PPE		**5.07**	**1**
Debit Operating Expenses	**4.93**		
Cr PPE		**4.93**	**1**
(Impairment 380-5.07-370)			

The fair value at 31st December 2018 is only relevant in terms of an impairment review of GSS assets

As the property is now measured at cost under IAS16 rules, the fair value does not need to be disclosed.

MOW

MOW is held for sale at 31st December 2018. MOW contiues to be presented as an IAS40 investment property until it is disposed of (ie IFRS5 *Non Current Assets held for sale and discontinued activities does not apply)* (IFRS5.5)

MOW will be adjusted to fair value at 31st December 2018

	(€'000)
Fair value MOW at 1.1.18	450
Fair value MOW at 31.12.18	440
Change	10

	(€'000)	(€'000)	
Debit Operating Expenses	**10**		
Credit IP		**10**	**3**

AGO

There is no change in use for AGO. AGO only needs to be restated to Fair Values at the year end.

	(€'000)
Fair value AGO at 1.1.18	750
Fair value AGO at 31.12.18	925
Change	175

	(€'000)	(€'000)	
Debit IP	**175**		**2**
Credit Operating Expenses		**175**	

Summary of Changes to Financial Statements GSS	(€'000)	
Operating Expenses (20+5.07+4.93+10-175)	**-135**	**(DECREASE)**
PPE (380-5.07-4.93)	**370**	**(INCREASE)**
IP (175-10-400)	**-235**	**(DECREASE)**

Issue (2) **10**

3. Grant Package IKAN

IAS20 Accounting for Government Grants and Disclosure of Government Assistance states that

Grant Package to be subdivided as follows:	[IAS20 19-21]	
Grants relating to Assets (Capital grants)	620,000	Deferred approach. Deferred and released to SOCI at 10% pa (as depreciation)
Grants relating to Revenue	180,000	Deferred and released to match costs

Capital Grant	(€'000)
Release to the SOCI in 2018	
(€620,000/10)	62
Current Liabilities (<12 months)	62
Non Current Liabilities (>12 months)	496

Revenue Grant

IAS20: Grant receivable relating to future periods should be recognised in the financial statements ona striaght line basis unless another basis is more appropriate. In this case 'another' method is more appropriate. As wages fluctuate the release of grant should reflect it.

	(€'000)	
Release of grant 2018		
(€70,000/€270,000*€180,000)	47	
Release in 2019		
(€90,000/€270,000*€180,000)	60	(current liabilities)
Release in 2020		
(€110,000/€270,000*€180,000)	73	(Non-current liabilities)
	180	

Correcting journal required

	(€'000)	(€'000)	
Debit Financial Liabilities	**800**		**2**
Credit Operating Income (reduce exps)		**109**	**4**
Credit deferred Income (< 12 months)		**122**	**1**
Credit deferred Income (> 12 months)		**569**	**1**

Summary of Changes to Financial Statements IKAN	(€'000)	
Operating income (IKAN)	**109**	**(INCREASE)**
Current Liabilities	**122**	**(INCREASE)**
Non Current Liabilities	**569**	**(INCREASE)**

Issue (3) **8**

4. *Leases*

To set up the lease

	(€'000)	(€'000)	
Debit Right of Use Assets	**44**		**1**
Debit Retained Earnings GSS	**5**		**1**
Credit Lease Liabilities		**49**	**1**

Schedule of Interest Payments

Year	Opening Liability	Rental	10% Charge	Closing Liability
1	49,173.00	15,512.00	4,917.30	38,578.30
2	38,578.30	15,512.00	3,857.83	26,924.13
3	26,924.13	15,512.00	2,692.41	14,104.54
4	14,104.54	15,512.00	1,407.00	-0.46

To correct 2018 entry

	(€'000)	(€'000)	
Debit Finance Charge	**4.92**		**1**
Debit Lease Creditor	**10.59**		**1**
Credit Operating Expenses		**15.51**	

Current Liabilities	11,654
Non Current Liabilities	26,924

Write-off of Right -of-Use Asset over remaining lease term.

	(€'000)	(€'000)	
Debit Operating Expenses	**11.04**		
Credit Right of Use Asset		**11.04**	**1**

Issue (4) **6**

5. Inventories BARN and IKAN

BARN:
Inventory measured at lower cost and NRV. NRV is net selling price
Inventory of €160,000 should be written down to NRV (€80000-€5,000)
Write down €85,000
Inventory of €90,000 should NOT be adjusted. Recoverable value is higher
Journal

	(€'000)	(€'000)	
Debit cost of sales BARN	**85**		**2**
Cr Inventory BARN		**85**	

IKAN
Intergroup trading. Any unrealised profit to be eliminated on consolidation:

Value unsold by the group	€500,000
Unrealised profit on goods	
(€500,000/1.25*.25)	€100,000

Journal

	(€'000)	(€'000)	
Debit Retained Earnings IKAN	**100**		**2**
Cr Inventory GSS Group		**100**	

Intercompany accounts reconciliation
Error in GSS

	(€'000)	(€'000)	
Debit intercompany a/c with IKAN	**50**		
Credit Trade receivables		**50**	**2**

and *then cancel intercompany accounts*
150k Trade Receivables
150k Trade Payables

Issue (5) **6**

6. Re-organisation Issue.
IAS37.71 'a provision for restructuring costs is only recognised when the general recognition criteria for provisions (legal or constructive) are recognised. GSS plan has been formalised and published at the employees have been notified before the year-end a constructive obligation exists at the year-end. Therefore a provision should be created. [IAS37.72]

The costs to be capitalised are the costs necessarily entailed by the restructuring and those not associated with ongoing activities [IAS37.73-80]. Thes include Redundancy costs and legal /administrative costs. (Continuing staff salary cost not part of plan. These relate to future conduct of business [IAS27.81]
Also note that only the basic redundancy cost per employee is included in provision €40,000 per employee). The e excess for those who stay on for another 12 months will be in lieu of work performed in 2019. Tthese will be treated as short term benefits in 2019/20 financial statements.
Provision for 2018 financial statements:

Administration Costs	€65,000
Redundancy :	
(25 employees by €40k per employee)	€1,000,000
Provision to be created	€1,065,000

Journal to incorporate the Provision.

	(€'000)	(€'000)	
Debit operating expenses	**1,065**		**5**
Credit Provisions		**1,065**	

Issue (6) **5**

7. Deferred Taxation GSS

Difference	€'000	Action		€'000 Tax effect
Permanent differences	10	None. Permanent differences will not reverse		n/a
Capital allOwances > book depreciation	400	Lower tax base. Actual rate temporarily less than effective rate. Will reserve Difference to income statement (timing difference)	[IAS12.17]	50

	(€'000)	(€'000)	
Debit Tax Expense	**50**		**5**
Cr Deferred tax Liability		**50**	

Issue (7) **5**

8. Impairment test.	(€'000)	(€'000)	
Debit Operating expenses	**60**		**3**
Credit Goodwill		**60**	

Issue (8) **3**

TOTAL **50**

Part (b)(ii) Consolidated Financial Statements
Summary of Marks. Details below

Consolidated Statement of Profit and Loss AND Other Comprehensive Income	10 marks
Consolidated Statement of Financial Position as at 31st December 2018	20 marks
	30 marks

Draft statement of comprehensive Income for the year ended 31 December 2018

			Consolidated SOCI €'000			Marks
Profit before tax:						
Per case study	(4,000+300+250)		4,550.00			0.5
Adjustments to operating profits :						
Issue (1)	Revenue GSS	14,280.00		13,289.55		1
Issue (2)	Investment Properties GSS	135.00				1
Issue (3)	Grant Package IKAN	108.67				1
Issue (4)	Leases GSS	4.47				1
Issue (4)	Leases GSS Finance Charge	-4.92				1
Issue (5)	Cost of Sales BARN	-85.00				0.5
Issue (5)	Unrealised Profit on intercompany trade	-100.00				0.5
Issue (6)	Reorganisation GSS	-1,065.00				1
Issue (8)	Impairment of goodwill	-60.00				0.5
	Adjusted Operating Profit		13,213			
Taxation						
Per case study	(330 +33+20)	383				
Issue (7)	Deferred Taxation GSS	50	433			1
Profit for the Period			17,330			
Other Comprehensive income			0			
Total Comprehensive Income			17,330			
TCI attributable to						
Equity Holders			17,275			0.5
Non Controlling Interests			55	20% (267+ 108.67 (grant) - 100 (Unrealised Profit))	55.13	0.5
					TOTAL	10

Draft statement of financial position as at 31 December 2018

	GSS €'000	IKAN €'000	BARN €'000	Consol €'000	Issue (1) €'000	Issue (2) €'000	Issue (3) €'000	Issue (4) €'000	Issue (5) €'000	Issue (6) €'000	Issue (7) €'000	Issue (8) €'000	Consolidatad €'000			Marks
ASSETS																
Non Current Assets																
Property, plant and equipment (NBV)	6,000	2,790	750			370							9,910			0.25
Investments																
Shares in IKAN	2,000			-2,000									0			
Shares in BARN	1,500			-1,500									0			
Goodwill				2,020								-60	1,960	(working 1 SOFP)		4.5
Right of Use Asset								33					33			0.25
Investment Properties	1,600					-235							1,365			0.5
	11,100	2,790	750										13,268			
Current Assets																
Inventories	3,490	700	350						-185				4,355			0.5
Trade Receivables	2,080	450	240		14,230				-200				16,800			0.5
Cash and cash equivalents	3,000	50	210										3,260			0.25
	8,570	1,200	800										24,415			
TOTAL ASSETS	19,670	3,990	1,550										**37,683**			
EQUITY and LIABILITIES																
Equity																
Ordinary shares €1 shares	6,000	300	500	-800									6,000			0.5
Share Premium	2,300												2,300			0.25
Retained Earnings	7,000	900	700										20,786	(Working (2)		4.25
Other Reserves	1,200												1,200			0.25
	16,500	1,200	1,200										30,286			
Non Controlling Interests													242	(working 3)		3
Non Current Liabilities																
Financial Liabilities	200	1,230											1,430			0.5
Deferred Taxation	250										50		300			0.5
Lease Liability > 12 months								27					27			0.5
Deferred Income							569						569			0.5
Retirement Benefit Obligations	600												600			0.25
	1,050	1,230	0										2,926			
Current Liabilities																
Payables	1,050	500	300						-200				1,650			0.5
Provisions										1,065			1,065			0.5
Lease Liability<12 months								12					12			0.5
Financial Liabilities	470	800					-800						470			0.5
Deferred Income							122						122		0	0.5
Current Taxation	600	260	50										910			0.25
	2,120	1,560	350										4,229			
TOTAL LIABILITIES	3,170	2,790	350										7,155			
TOTAL EQUITY AND LIABILITIES	19,670	3,990	1,550										**37,683**			
															TOTAL	20

Working (1) Goodwill on Consolidation (Breakdown of 4.5 marks per SOFP as follows)

IKAN

Acquisition of IKAN

	(€'000)		
Purchase Price	2,000		
% Share Capital			
(80%*300k)	240		
% reserves at acquisition			
(80% *400k)	400		
goodwill	1,360		1.5

BARN

Acquisition of IKAN

	(€'000)		
Purchase Price	1,500		
% Share Capital			
(100%*500k)	500		
% reserves at acquisition			
(100% *340k)	340		
goodwill	660		1.5
Total Goodwill		2,020	
Impairment (issue 8)		-60	1.5
Figure per SOFP		**1,960**	**4.5**

Working (2) Consolidated Retained Earnings **(Breakdown of 4.25 marks per SOFP as follows)**

		(€'000)			
Parent				7,000.00	0.2
Plus/Minus					
adjs to Profit before tax:					
issue (1)	Revenue		14,280.0		0.4
issue (2)	Investment Properties		135.0		0.8
issue (4)	Leases		4.5		0.3
	Finance Charge		-4.9		0.15
issue (6)	Re-organisation		-1,065.0	13,349.6	
Other					
issue (8)	Goodwill		-60.00		0.3
Issue (7)	adjs to taxation		-50.00		0.2
Issue (1)	Opening reserves Issue (1)		-50.00		0.3
Issue (4)	Opening reserves issue (4)		-5.01	-165.01	0.2
				20,184.54	
BARN					
Retained Earning at 31.12.18					
Per question		700.00			0.2
Issue (5)		-85.00			0.2
		615.00			
Reserves at acquisiton		340.00			0.2
Post Acquisition		275.00			
100% Controlling share				275	
Consolidated Reserves				20,786.48	**4.25**

Working (3) Non Controlling Interests

IKAN		
Share Capital (20% of 300k)	60	1.5
Retained earnings (20% of 908.67k)	182	1.5
	242	3

Appendix 2

(c) Evidence of knowledge of rules of IAS37 (4 marks)
Argument for level of disclosure (3 marks)
Ratios for Gearing Levels. (3 marks)

This is an ethical dilemma for the directors – should they disclose details of the ongoing case in the 2018 financial statements? Or should they accrue costs? Or should they say nothing at all and hope that the final decision goes in their favour?

Conor and Andrew would prefer to keep any details out of the financial statements in 2018 and 2019. They claim that disclosure would be a reputational hazard for the company (but they also hope that they can agree a price with Ocean O before the proceedings are over). They claim that as a final verdict has not yet been reached there is no need to create a liability for costs. Indeed as the case is still a work in progress their preference would be to say nothing at all and hope for the best.

IAS37 *Provisions, Contingent Liabilities and Contingent assets* provides guidance on the accounting for and disclosure of provisions continent liabilities and contingent assets. IAS37 defines a provision as a liability of uncertain timing or amount while contingent liabilities are possible obligations whose existence will be confirmed by uncertain future events that are not wholly within the control of the entity. Provisions should be accrued in the financial statements while contingent liabilities are disclosed in a note. IAS37 also states that if a liability is remote that it should be omitted from the accounts altogether as its inclusion could cause unnecessary confusion.

It would appear from the facts above that the unfavourable outcome of this case is at either the highly likely stage or probable stage. The outcome of the case is becoming clear and it is not falling in GSS favour. Therefore disclosure should be made. It would be both unethical and in contravention of IFRS if the case were not reported this year. In addition it would seriously jepordise the future relationship between GSS and Ocean O if the directors were not totally forthcoming about the events.

If GSS are to treat this as a contingency (rather than a provision), disclosure should include a brief description of the nature of the event and, where practicable, an estimate of its financial effect and an indication of the uncertainties relating to the timing and the possibility of any re-imbursement. If a provision is to be made (students can argue either way) the amount recognised should be a best estimate of the expenditure required to settle the obligation at the balance sheet date. This means that one-off items, such a lawsuit, are measured at the most likely amount. This would mean that be €6m would be recognised. The possibility of the defendant paying his own legal costs should be detailed separately but only if this possibility is likely to happen.

Finally the directors may be able to apply the guidance in IAS37 (PARG 92). IAS 37 paragraph 92 permits a company not to disclose the information required by paragraphs 84-89 if the disclosure of the information is expected to prejudice seriously the position of the company in a dispute with other parties on the subject matter of the provision. In such cases, paragraph 92 requires the company to disclose the general nature of the dispute.

Gearing levels of GSS group would increase only if the lawsuit is treated as a provision in the financial statements. In that case the level would increase from 41.47% (€9,725k/€23,448k) to 67% (€15,725/€23,448k).